Oversight Hearing On Dairy Termination Program[1]

I appreciate this invitation and opportunity to review the status of the Dairy Termination Program and evaluate the impact it is having on the dairy and red meat industries. My comments are essentially a reflection of what is happening in the greater Ohio area, or the eastern Corn Belt. Four large Federal milk order markets, including Ohio Valley (No. 33), Eastern Ohio-Western Pennsylvania (No. 36), Indiana (No. 49), and Southern Michigan (No. 40), plus a small proportion of Grade B milk (less than 10 percent) are identified in this region.

A first point to make is that Ohio, Pennsylvania, and Indiana had a lower rate of participation in the Dairy Termination Program than the national average. In terms of 1985 marketings of milk, an estimated 8.7 percent of U.S. milk production was contracted out of production. The comparable rates for Ohio, Pennsylvania, and Indiana were 5.5 percent, 2.8 percent, and 7.3 percent respectively. Only Michigan at 11.7 percent participation exceeded the national average in my area of focus.

Milk Production Situation

Five months into the Dairy Termination Program, we are seeing a significant impact of the program on U.S. milk production. For the first time since the end of the milk diversion program, monthly milk production has declined from the same month the previous year (July, 1986 milk production down by 1 percent from July, 1985). Monthly declines of even larger magnitude will continue to occur through mid-1987.

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[1]Robert E. Jacobson, Professor, Agricultural Economics, The Ohio State University, for presentation to the Subcommittee on Livestock, Dairy, and Poultry of the House Agriculture Committee, Longworth House Office Building, Washington, D.C., September 10, 1986.

At the regional level, however, impacts vary depending on the level of Dairy Termination Program participation. In both Ohio and Pennsylvania, for example, July milk production was up by 1 percent; Michigan, with its higher rate of participation, recorded a 3 percent decline in milk production. A pattern for the next several months appears to be emerging. States and regions having less than 5-6 percent of their 1985 marketings Terminated will observe no change to slightly more milk production. States and regions reflecting higher levels of participation will record lower milk production levels.

Milk cow numbers in the United States began increasing late in the Diversion program (1st quarter of 1985), numbered 11,086,000 a year ago (July, 1985), and peaked out at 11,183,000 cows in December, 1985. The recent July 1 dairy cow count placed the herd at 10,850,000 cows; that reflects a net reduction of 200,000 milk cows from July, 1985 (minus 1.8 percent), and a net reduction of 333,000 milk cows since December, 1985 (minus 3.0 percent).

Meanwhile, increases in production per cow are partially offsetting the reduction in cow numbers. After reaching a record 13,031 pounds per cow in 1985, the industry will record a 350 to 400 pound per cow increase in 1986 (plus 3 percent). The Dairy Termination Program clearly is working in terms of reducing milk cow numbers and milk production, but the inevitable increases in milk cow productivity are diluting the impact. Every 1 percent increase in production per cow requires a net reduction of 108,000 milk cows in the United States to maintain production at the same level.

While the Dairy Termination Program is providing an effective short term solution to the dairy surplus problem, other economic forces are shifting resources out of milk production on a long term basis. For example, in July, 1986, Milk Marketing, Inc., the large regional dairy cooperative headquartered

near Cleveland, Ohio (8,000 members), had 64 dairy farm sales occur across their membership. Over half of these farm sales were not associated with the Dairy Termination Program.

Two factors seem to explain this faster than normal rate of exit:

1. The longer term drop in the market price situation is beginning to catch up with some milk producers. Farm milk prices have dropped each year since 1981. The "All Milk Wholesale" price this summer has averaged $11.90 per cwt., about $2.00 lower than was the case five years ago. Subtract the 52 cent buyout assessment from that price, and the revenue side is hurting.

2. Pessimism about the future is also a factor. Dairy farmers have reviewed the price support schedule set forth in the Food Security Act of 1985 and have noted the possibility of a $9.60 support price in 1990. They also recognize that support prices could be further reduced by Gramm-Rudman adjustments. Furthermore, there is an apprehension about the impact of new technology (bovine growth hormone, iso-acid supplements, embryo transplants, etc.) on the supply side of the market. So the mood is not that positive. Milk production has turned downward, not solely because of the Dairy Termination Program.

One factor that continues to influence milk production positively is the cost of feed. In July, 1986, the average producer milk price in the United States was $11.90, and the price of 16 percent mixed dairy ration was $159 per ton. These numbers generated a milk-feed price ratio of 1.50, higher than the 1.44 recorded in July 1985, and one that is economically favorable to the dairy enterprise. Higher milk prices this fall, in the face of depressed grain prices, will further improve the milk-feed price ratio. The longer term prospects for low feed costs with increases in production per cow, suggest that

the long term surplus situation is not behind us, and another Milk Reduction Program in 1988 may be appropriate.

Heifer Potential

The July 1, 1986 Cattle Inventory for the United States reported a total of 4,700,000 "dairy heifers 500 pounds and over," a reduction of 300,000 dairy heifers from a year ago. The ratio of heifers to milk cows has also decreased in the past year from 45.2 to 43.3 heifers per 100 milk cows. Obviously, the 6 percent decline in dairy heifers from a year ago is at a substantially greater rate than the 1.8 percent decline in milk cow numbers from a year ago. However, the 43.3 ratio is still a very high ratio relative to historic standards (about 35), and the potential for increasing milk production continues to hold.

Regional and State data on dairy replacements were not available on the mid-year count. However, on January 1, 1986, when the U.S. dairy heifer/milk cow ratio stood at 42.6, the ratio for the states I am reporting were: Ohio - 42.3; MIchigan - 48.4; Pennsylvania - 38.8; and Indiana - 49.8. While Pennsylvania's ratio is low by comparison, its limited participation in the Dairy Termination Program suggests that dairy heifer numbers in Pennsylvania will improve relative to other states. There continues to be a strong regional capacity for milk production in terms of dairy heifer availability.

Status of CCC Purchases In Region

For the time being, surplus milk in the United States has virtually disappeared. There have been no Commodity Credit Corporation purchases of butter since mid-July, and cheese and powder purchases are way down from a year ago. For example, in the last week of August, the milk equivalent of CCC

purchases was 24.3 million pounds as compared to 239.8 million pounds for the same week in August, 1985.

A similar pattern shows for CCC purchases in the eastern Corn Belt. Our region has never been much of a surplus seller to the government because supplies have been in reasonable balance with demand for the most part. The regional cooperative, Milk Marketing, Inc., through its Dairy Farm Products subsidiary, has milk manufacturing plants at Orville, Ohio; Dayton, Ohio; and Goshen, Indiana. The MMI plants are usually the only plants in Ohio, Indiana, and Western Pennsylvania that make dairy product available for government purchase.

In the following table, a comparison of dairy product sales to the Commodity Credit Corporation from MMI plants for the April through August periods in 1985 and 1986 are recorded. April was selected as the beginning month because April, 1986 marked the initiation of the Dairy Termination Program.

Table 1. Sales of Butter and Nonfat Dry Milk From Milk Marketing, Inc. Plants To The Commodity Credit Corporation, April - August, 1985 and 1986

	1985		1986	
	Butter	Nonfat Dry Milk	Butter	Nonfat Dry Milk
April	1,495,300 Lbs.	2,076,600 Lbs.	2,857,100 Lbs.	3,307,300 Lbs.
May	2,184,800	4,499,900	1,922,600	3,763,500
June	1,239,000	4,050,000	933,800	4,813,200
July	376,900	5,099,000	0	1,519,500
August	0	3,409,900	0	0
Total	5,296,000 Lbs.	19,135,400 Lbs.	5,713,500 Lbs.	13,403,500 Lbs.

Source: Phone conversations with MMI management personnel 9/2/86.

The significant points to note from the Table 1 data are the major drop in powder sales to the government in July and August, 1986, and the complete absence of butter sales to CCC in July and August, 1986. At this juncture, MMI does not expect to make any more product sales to the Commodity Credit Corporation this calendar year.

Other products are processed at these plants, especially ice cream mix and condensed skim milk. Commercial sales of all of the plants' products have been much stronger in 1986 than 1985, further reducing sales to the government.

The Dairy Termination Program clearly has been the key factor in reducing dairy product sales to the government in the summer of 1986. However, the geographic distribution of dairy farmers exiting under the program in this region has been widespread and no pockets of milk shortage have occurred in the area.

Normal Culling Rates

The initial contracts in the Dairy Termination Program called for the elimination of 951,619 dairy cows and 340,789 heifers (as well as 257,995 calves). A ratio of 35.8 heifers per 100 milk cows was implicitly defined for Termination.

The decrease in the ratio of heifers to milk cows by two animals (45.2 to 43.3) on July 1, 1986 as compared to a year ago indicates some acceleration in the heifer culling rate (or preventing calves from gaining heifer status).

Culling rates of milk cows have also appeared to move at a somewhat faster rate than has been the case in recent years. While this is obviously so for producers in the Dairy Termination program, the culling rate by dairy farmers not in the program also appears to be somewhat higher. The two factors that explain the modest increase in culling rate are (1) some back-off from the race for base phenomenon that presumably influenced some dairymen, and (2) an expectation for lower milk prices in the future that would mean more risk to expanded operations.

While culling rates are somewhat higher, and about 700,000 dairy cattle have now been slaughtered in the Dairy Termination program, we have not observed any particular disturbance in the slaughter markets in our region. Cull cow prices have been in the $35 to $40 range throughout 1986, better than the second half of 1985 and slightly under the first half of 1985. Similarly, choice beef prices are higher than they were a year ago and have been reasonably strong this summer in the $58-59 range. The bulge of dairy cattle coming into the beef market this past five months evidently has left beef prices somewhat lower than expectations, but the markets in our region have absorbed this stock with no particular problem.

In conclusion, the Dairy Termination Program is working effectively as a short and intermediate term solution to the dairy surplus problem. Lower producer milk prices are also having their impact. Strong commercial demand, up by nearly 4 billion pounds in 1986 over 1985, has been fundamental to the improvement.